SCAN Long Term Care

Financial Statements as of and for the Years
Ended December 31, 2010 and 2009, and
Independent Auditors' Report

SCAN LONG TERM CARE

TABLE OF CONTENTS

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
SCAN Long Term Care:

We have audited the accompanying statements of financial position of SCAN Long Term Care (the "Company") as of December 31, 2010 and 2009, and the related statements of activities and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2010 and 2009, and the results of its operations, changes in its net assets, and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Deloitte + Touche LLP

April 25, 2011

SCAN LONG TERM CARE

STATEMENTS OF FINANCIAL POSITION
AS OF DECEMBER 31, 2010 AND 2009

	2010	2009
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$22,768,069	$26,918,495
Premiums and other receivables — net	6,729,483	7,699,491
Prepaid expenses and other current assets	28,244	25,308
TOTAL	$29,525,796	$34,643,294
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES:		
Accounts payable and accrued expenses	$ 598,375	$ 318,116
Accrued payroll and related benefits	906,903	712,022
Medical claims payable	14,919,669	16,047,960
Due to parent and affiliates	1,769,467	1,636,800
Other current liabilities	1,321,558	4,412,350
Total liabilities	19,515,972	23,127,248
COMMITMENTS AND CONTINGENCIES (Note 6)		
NET ASSETS	10,009,824	11,516,046
TOTAL	$29,525,796	$34,643,294

See notes to financial statements.

SCAN LONG TERM CARE

STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS
FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009

	2010	2009
NET REVENUES:		
Premiums and reinsurance recoveries	$126,201,015	$120,111,196
Supplemental premiums	327,542	183,916
Interest income	44,720	45,692
Total net revenues	126,573,277	120,340,804
OPERATING EXPENSES:		
Hospital, physicians, and other services	108,380,381	98,540,076
Medical administration expenses	5,148,684	4,330,647
Marketing, general, and administrative expenses	14,550,434	11,640,037
Depreciation and amortization		179,288
Total operating expenses	128,079,499	114,690,048
CHANGE IN NET ASSETS BEFORE FUND TRANSFER	(1,506,222)	5,650,756
FUND TRANSFER TO SCAN HEALTH PLAN ARIZONA		6,000,000
DECREASE IN NET ASSETS	(1,506,222)	(349,244)
NET ASSETS — Beginning of year	11,516,046	11,865,290
NET ASSETS — End of year	$ 10,009,824	$ 11,516,046

See notes to financial statements.

SCAN LONG TERM CARE

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009

	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES:		
Decrease in net assets	$ (1,506,222)	$ (349,244)
Adjustments to reconcile decrease in net assets to net cash (used in) provided by operating activities:		
Depreciation and amortization		179,288
Fund transfer to SCAN Health Plan Arizona		6,000,000
Changes in operating assets and liabilities:		
Premiums and other receivables — net	970,008	(5,214,138)
Prepaid expenses and other current assets	(2,936)	(25,308)
Accounts payable and accrued expenses	280,259	209,348
Accrued payroll and related benefits	194,881	302,123
Medical claims payable	(1,128,291)	3,254,738
Due to parent and affiliates	132,667	170,178
Other current liabilities	(3,090,792)	3,283,184
Net cash (used in) provided by operating activities	(4,150,426)	7,810,169
CASH FLOWS FROM FINANCING ACTIVITIES — Fund Transfer to SCAN Health Plan Arizona		(6,000,000)
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(4,150,426)	1,810,169
CASH AND CASH EQUIVALENTS — Beginning of year	26,918,495	25,108,326
CASH AND CASH EQUIVALENTS — End of year	$22,768,069	$26,918,495

See notes to financial statements.

1. ORGANIZATION

SCAN Long Term Care (the "Company") is an Arizona nonprofit corporation that is located in Phoenix, Arizona. The Company was recognized by the Internal Revenue Service ("IRS") as exempt from federal income taxes in accordance with Internal Revenue Code ("IRC") Section 501(c)(4) on April 24, 2008. SCAN Health Plan Arizona is the sole corporate member of the Company. SCAN Health Plan Arizona is licensed with the Arizona Department of Insurance, and was also recognized by the IRS as a tax-exempt organization described in IRC Section 501(c)(4) on April 24, 2008. SCAN Group is the sole corporate member of SCAN Health Plan Arizona. SCAN Group is also the sole corporate member of SCAN Health Plan, an affiliated entity.

On May 1, 2006, the Arizona Health Care Cost Containment System ("AHCCCS") entered into a contractual agreement with the Company to participate in the Arizona Long Term Care System ("ALTCS") program. ALTCS is the State of Arizona Medicaid program that administers acute care, long-term care, behavioral health, and case management services to frail seniors and the physically disabled. The enrollment of participants in the Company's managed care plan initially began on October 1, 2006; the contract was renewed for the new contract year, which began October 1, 2010, and is limited to residents of Maricopa County in the State of Arizona.

2. REGULATORY REQUIREMENTS AND OPERATIONS

The Company is subject to regulatory oversight by AHCCCS and is required to periodically file financial statements with AHCCCS in accordance with various accounting and reporting practices. At December 31, 2010 and 2009, the Company's minimum capitalization requirement was $4,500,000 for both years as compared to actual capitalization of $10,009,824 and $11,516,046, respectively.

In addition to the minimum capitalization requirements, the Company is required to establish and maintain (i) a performance bond of standard commercial scope issued by a surety company doing business in the State of Arizona, (ii) an irrevocable letter of credit, or (iii) a cash deposit with AHCCCS or for as long as the Company has AHCCCS-related liabilities of $50,000 or more outstanding, or 15 months following the termination date of the contract with AHCCCS, whichever is later, to guarantee (i) payment of the Company's obligations to providers and (ii) performance by the Company of its obligations under the AHCCCS contract. As of December 31, 2010 and 2009, SCAN Group maintained a letter of credit with U.S. Bank in the amounts of $8,163,445 and $7,333,142, respectively, on behalf of the Company in satisfaction of this requirement. No amounts were withdrawn on the letter of credit in 2010 or 2009.

As of December 31, 2010, the Company is in compliance with all of the financial viability standards and performance guidelines required by the AHCCCS contract with the exception of the contract requirement limiting the Company's total administrative cost percentage. As of December 31, 2010, the Company's administrative cost percentage was 12% as compared to the performance guideline of not more than 8%. As of December 31, 2009, the Company was in compliance with all of the financial viability standards and performance guidelines, including without limitation, the administrative cost percentage requirement. For the contract years ended September 30, 2010 and 2009, the Company's administrative cost percentage was 10% and 7%, respectively, as compared to the performance guideline of not more than 8%.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation — The accompanying financial statements include the accounts of the Company and have been prepared in accordance with accounting principles generally accepted in the United States of America ("generally accepted accounting principles"), including Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 958, *Not-for-Profit Entities*. FASB ASC 958 establishes standardized external financial reporting by not-for-profit organizations.

Generally accepted accounting principles require not-for-profit organizations to report information regarding their financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets, based on the existence or absence of donor-imposed restrictions. As of December 31, 2010 and 2009, the Company had no temporarily or permanently restricted net assets or contributions.

Use of Estimates — Management uses estimates and assumptions in preparing the financial statements in accordance with generally accepted accounting principles. Those estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported revenues and expenses. Actual results could vary from the estimates that were assumed in preparing the accompanying financial statements.

Cash and Cash Equivalents — Cash and cash equivalents primarily include highly liquid debt instruments purchased with a maturity of three months or less, as well as cash on hand and on-demand bank deposits.

Premiums and Other Receivables — Premium receivables include the capitation and reinsurance receivable due from AHCCCS. Other receivables include amounts due from members, claims due from providers, and pharmacy rebates. The Company establishes an allowance for those accounts that are estimated to have credit risk. Management does not believe that there are significant credit risks associated with the outstanding receivable from AHCCCS. See Note 6 for the associated concentration risk with AHCCCS.

Revenue Recognition — Under the contracts with AHCCCS, revenue is recognized based on the number of eligible members per month, multiplied by the contracted monthly rate. Revenue is recorded in the month in which eligible members are entitled to health care services.

The Company is also paid monthly for all prior-period coverage ("PPC") member months, including partial member months by AHCCCS. PPC revenue is recorded as premiums revenue in the statements of activities and changes in net assets in the month in which eligible members are entitled to health care services.

In the monthly capitation payments from AHCCCS, there is an assumed deduction for the share of cost ("SOC"), which members contribute to the cost of care. After the end of the contract year, AHCCCS compares actual SOC assignment to the assumed SOC in the calculation of the capitation rate, and the difference, if any, will be a receivable from, or a payable to, AHCCCS. The Company fully reconciles assumed SOC to actual SOC assignment on a monthly basis. As of December 31, 2010 and 2009, the Company recorded receivables related to this reconciliation of $535,647 and $249,218, respectively, which are included in premiums and other receivables in the statements of financial position.

In accordance with the AHCCCS contract, the Company performed a medical expense reconciliation based on membership level, claim payments, and encounter claim submissions and concluded negotiations on a settlement with AHCCCS during 2009. This reconciliation process resulted in an

amount due to AHCCCS of $2,227,505 for adjustment of premiums for the 2006 contract year, which was included in other current liabilities in the statement of financial position as of December 31, 2009, and reduced premium revenue for the year ended December 31, 2009.

The Company's capitation rate is based in part on the assumed ratio of Home and Community Based Services ("HCBS") months to the total number of member months. At the end of the contract year, AHCCCS compares the actual HCBS member months to the assumed percentage that is used to calculate the dual and nondual full long term care capitation rate for that year. If the Company's actual percentage is different than the assumed percentage, AHCCCS recoups or reimburses the difference between the number of HCBS member months, which exceeded or was less than the assumed percentage. This process resulted in an amount due to AHCCCS of $1,321,558 and $2,028,493 as of December 31, 2010 and 2009, respectively, which is included in other current liabilities in the statements of financial position, and reduced premium revenue for the years ended December 31, 2010 and 2009.

AHCCCS requires a reconciliation process for the Company as its total PPC medical experience, excluding administrative and nonoperating expenses, is 10% higher or lower than the reimbursement associated with PPC, which is PPC capitation revenue excluding administrative add-on. PPC is the period prior to the member's enrollment, during which a member is eligible for covered services. The time frame is from the effective date of eligibility to the day a member is enrolled with the Company. This reconciliation process resulted in no amount due to AHCCCS for the year ended December 31, 2010. This reconciliation process resulted in an amount due to AHCCCS of $147,332 for the year ended December 31, 2009, which is included in other current liabilities in the statement of financial position as of December 31, 2009, and reduced premium revenue for the year ended December 31, 2009.

Certain estimates are required to record revenues and accounts receivable at net realizable value due to the nature of the membership contracts, specifically eligibility changes in the membership base. These estimates are based on actual historical adjustments to monthly capitation premiums. Inherent in these estimates is the risk that they will have to be adjusted as additional information becomes available. Such adjustments are typically identified and recorded at the point of cash application or account review. Medicaid revenues are subject to audit and retroactive adjustment by AHCCCS. Laws and regulations governing this program are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount.

Reinsurance — Reinsurance is a stop-loss program provided by AHCCCS for the partial reimbursement of covered medical services incurred for a member beyond an annual deductible; the deductible is the responsibility of the Company. Reinsurance recoveries of $3,834,794 and $10,262,903 for the years ended December 31, 2010 and 2009, respectively, are included in premiums and reinsurance recoveries in the statements of activities and changes in net assets.

Hospital, Physicians, and Other Services — The cost of health care services is recognized in the period in which services are provided and includes an estimate of the cost of services that have been incurred but not yet reported. The Company estimates the amount of the provision for service costs incurred but not reported ("IBNR") using standard actuarial methodologies based upon historical data, including the period between the date services are rendered and the date claims are received and paid, denied claim activity, expected medical cost inflation, seasonality patterns, and changes in membership. The estimates for service costs IBNR are made on an accrual basis and are adjusted in future periods as required. Any adjustments to the prior-period estimates are included in the current period. Such estimates are subject to the impact of changes in the regulatory environment and economic conditions. Given the inherent variability of such estimates, the actual liability could differ significantly from the amounts provided.

The Company assesses the profitability of its Medicaid contract for providing health care services when operating results or forecasts indicate probable future losses. The Company establishes a premium deficiency liability in current operations to the extent that the sum of expected future costs, claim adjustment expenses, and maintenance costs exceeds related future premiums under contract. For purposes of determining premium deficiencies, contracts are grouped in a manner consistent with the Company's method of acquiring, servicing, and measuring the profitability of such contracts. Premium deficiencies, if any, are recognized in the period the loss is determined and are classified as hospital, physicians, and other services expenses. Losses recognized as a premium deficiency result in a reduction to expenses in subsequent periods as operating losses under these contracts are charged to the liability previously established. The Company did not record any premium deficiency reserves as of December 31, 2010 and 2009.

While the ultimate amount of claims and expenses is dependent on future developments, management believes the liability for medical claims payable and the medical expenses included in the financial statements are reasonable estimates to cover such costs.

Medical Administration Expenses — Medical administration expenses include salaries, benefits, travel, and training expenses for the case managers and case management supervisors.

Marketing, General, and Administrative Expenses — These expenses include salaries, benefits, premium tax, marketing, other general administrative expenses, and allocations from SCAN Group, SCAN Health Plan, and SCAN Health Plan Arizona.

Depreciation and Amortization — Costs associated with the development of internal-use software, especially for the ALTCS program, were capitalized in accordance with FASB ASC 340-40, *Intangibles — Goodwill and Other, Internal-Use Software*. Amortization was provided on the straight-line method over three years. The Company has recorded $717,141 of computer software that is fully amortized as of December 31, 2010 and 2009.

Income Taxes — The Company is an Arizona nonprofit corporation that filed for recognition by the IRS as exempt from federal income taxes in accordance with IRC Section 501(c)(4) and was approved in April 2008. Management believes the Company is in compliance with the provisions of IRC Section 501(c)(4) and is exempt from federal tax under IRC Section 501(a). In addition, the Company is an exempt organization for state tax purposes pursuant to Arizona Revised Statutes § 43-1201 (A)(6).

Fair Value of Financial Instruments — The carrying amounts of cash and cash equivalents, premiums and other receivables, accounts payable and accrued expenses, and medical claims payable at December 31, 2010 and 2009, respectively, approximate fair value because of the relatively short period of time between origination of the instruments and their expected liquidation.

Subsequent Events — The Company has evaluated subsequent events through April 25, 2011, the date the Company's financial statements were available to be issued.

Recent Accounting Pronouncements — In August 2010, the FASB issued Accounting Standards Update ("ASU") No. 2010-24, *Presentation of Insurance Claims and Related Insurance Recoveries* ("ASU 2010-24"), which clarifies that a health care entity should not net insurance recoveries against a related claim liability. Additionally, the amount of the claim liability should be determined without consideration of insurance recoveries. The adoption of ASU 2010-24 is effective for the Company beginning January 1, 2011. The adoption of ASU 2010-24 is not expected to have a material impact on the Company's financial statements.

4. PREMIUMS AND OTHER RECEIVABLES — NET

Receivables as of December 31, 2010 and 2009, consist of the following:

	2010	2009
Premiums receivable from AHCCCS	$ 535,647	$ 249,218
Reinsurance receivable from AHCCCS	6,148,942	7,422,564
Supplemental premium receivable	25,365	16,239
	6,709,954	7,688,021
Less allowance for doubtful accounts	(18,522)	(13,408)
Premiums receivable — net	6,691,432	7,674,613
Pharmacy rebates	34,000	22,000
Other receivable	4,051	2,878
Other receivable — net	38,051	24,878
Total	$6,729,483	$7,699,491

5. MEDICAL CLAIMS PAYABLE

Activity in medical claims payable as of December 31, 2010 and 2009, is as follows:

	2010	2009
Beginning balance	$ 16,047,960	$ 12,793,222
Incurred related to:		
Current period	110,260,472	99,017,555
Prior periods	(1,880,091)	(477,479)
	108,380,381	98,540,076
Paid related to:		
Current period	(95,486,071)	(83,078,708)
Prior periods	(14,022,601)	(12,206,630)
	(109,508,672)	(95,285,338)
Total	$ 14,919,669	$ 16,047,960

As a result of payments made in the current year related to prior years' estimated claims, the provision for medical claims payable and claim adjustment expense decreased by $1,880,091 and $477,479 for the years ended December 31, 2010 and 2009, respectively, due to a lower-than-anticipated settlement of claims.

Liabilities for unpaid claims and claim expenses are estimates of payments to be made under health coverage for reported but unpaid claims and for incurred but not yet reported claims. Management develops these estimates using actuarial methods based upon historical data for payment patterns, cost trends, product mix, seasonality, utilization of health care services, and other relevant factors.

6. COMMITMENTS AND CONTINGENCIES

Cash Concentration — The Company maintains the majority of its cash and cash equivalents in one financial institution, which subjects the Company to concentrations of credit risk related to temporary cash investments. As of December 31, 2010, the Company had bank deposits that were approximately $22,518,069 in excess of the maximum amounts insured by the Federal Deposit Insurance Corporation.

Credit Concentration — Substantially, all of operating revenues for the years ended December 31, 2010 and 2009, result from contracts with AHCCCS. AHCCCS's cancelation or nonrenewal of its contract with the Company or nonpayment of amounts due to the Company would have a material adverse effect on the Company's financial position and changes in net assets.

Medical Claims Risk — The Company is exposed to certain medical claims risk due to the nature of its operations. The majority of medical services provided for the Company's members are performed under contract. However, the Company regularly incurs costs for noncontracted services from providers. In addition, in the event of default or financial difficulties with certain providers, the Company could be liable for outstanding claims, which, if substantial, could have a material adverse effect on the Company's financial position and changes in net assets.

Cost Containment Measures — Both government and private pay sources have instituted cost containment measures designed to limit payments made to providers of health care services, and there can be no assurance that future measures designed to limit payments made to providers will not adversely affect the Company's financial position.

Professional Liability Insurance — The Company carries professional liability insurance with coverage of $5,000,000 per occurrence and in aggregate in any one year. In the ordinary course of business, the Company is subject to the claims of its members arising out of decisions to restrict treatment or to restrict reimbursement for certain services.

Regulatory Proceedings and Litigation — In the ordinary course of its business operations, the Company is also subject to periodic reviews by various regulatory agencies with respect to the Company's compliance with a wide variety of rules and regulations applicable to the Company's business, which may result in the assessment of regulatory fines or penalties. Additionally, the Company is also party to various legal actions arising in the normal course of business. These other regulatory and legal proceedings are subject to many uncertainties, and, given their complexity and scope, their final outcome cannot be predicted at this time. However, after taking into consideration legal counsel's evaluation of such legal and regulatory actions, management believes the outcome of these matters will not have a material adverse effect on the Company's financial position or changes in net assets.

Health Reform — On March 23, 2010, President Obama signed the Patient Protection and Affordable Care Act into law, and then on March 30, 2010, President Obama signed into law the Health Care and Education Affordability Reconciliation Act of 2010 (collectively, "health insurance reform"). The Company is evaluating the effect that health insurance reform may have on its financial position and changes in net assets.

7. TRANSACTIONS WITH SCAN GROUP, SCAN HEALTH PLAN, AND SCAN HEALTH PLAN ARIZONA

The Company made a $6 million fund transfer to SCAN Health Plan Arizona on December 10, 2009, which was approved by the Board of Directors.

The Company does not have any employees and receives all of its support from affiliates. SCAN Group and SCAN Health Plan provide administrative services in support of the operations of the Company and SCAN Health Plan Arizona. The Company and SCAN Health Plan Arizona have agreed to reimburse SCAN Group and SCAN Health Plan for providing and arranging legal, accounting and financial, information technology, and other services. The amount of the expenses to be reimbursed to SCAN Group and SCAN Health Plan is allocated to the Company based on different allocation methods by each department of SCAN Group and SCAN Health Plan. The charges for these services to the Company totaled $4,673,748 and $4,034,016 in 2010 and 2009, respectively, and are included in administrative expenses in the statements of activities and changes in net assets.

As of December 31, 2010, the Company recorded payables due to SCAN Group, SCAN Health Plan, and SCAN Health Plan Arizona of $201,624, $294,524, and $1,273,319, respectively, which are included in due to parent and affiliates in the statements of financial position. As of December 31, 2009, the Company recorded payables due to SCAN Group, SCAN Health Plan, and SCAN Health Plan Arizona of $186,723, $363,097, and $1,086,980, respectively, which are included in due to parent and affiliates in the statements of financial position. These amounts represent balances due for costs incurred in the ordinary course of business by, or on behalf of, the Company. The amounts were settled through intercompany settlement within 30 days of year-end.

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